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COMMENTS

U.S. DEPARTMENT OF ENERGY
NOTICE OF PROPOSED RULE MAKING
RIN 1901-AB21

LOAN GUARANTEES FOR
PROJECTS THAT EMPLOY INNOVATIVE TECHNOLOGIES

SUBMITTED TO:

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SECTION INDEX

SECTION 1
INTRODUCTION & BACKGROUND

My company, Synergistic Dynamics, Inc. ("SDI"), and I have extensive experience with the U.S. Maritime Administration's loan guarantee program known as "Title XI" (of the Merchant Marine Act of 1936, as amended). On a number of occasions, we have recommended that DOE model the regulations of its Title XVII loan guarantee program on the regulations [1] governing the U. S. Maritime Administration's Title XI. We repeat that recommendation in these comments.

Title XI is a mature program with well-established administrative policies and procedures in place. It has recently undergone an intensive review by the Government Accountability Office (GAO) and the Department of Transportation's Inspector General (IG). the Maritime Administration (MARAD) has responded to those reviews by establishing a more coherent management structure and more robust procedures for administering the guaranteed loans in its portfolio.

Our interest in DOE's new loan guarantee program dates back to August 2001 when Representative Rick Larsen of Washington introduced a Bill (H.R.2774) in the 1st session of the 107th Congress to establish a loan guarantee program for renewable energy source facilities. We offered to assist Representative Larsen's staff in drafting a set of regulations modeled on the Maritime Administration's Title XI program; however, Congressman Larsen did not pursue the legislation.

Following the enactment of the Energy Policy Act of 2005, we made a similar offer to DOE, and presented a draft of our proposed regulations in a letter to DOE [2] in November 2005.

1.1 TECHNICAL QUALIFICATIONS

In addition to my experience in corporate finance and Federal loan guarantee programs, I am highly qualified to comment on the program's technology issues.

I was awarded an engineering scholarship by the Grumman Aircraft Engineering Corporation (now part of Northrop Grumman) which enabled me to attended Cornell University where I earned a degree in Mechanical Engineering and took graduate-level courses in aeronautical engineering. Following service in the US Naval Reserve, I was employed by units of the Grumman organization for twenty four years. During my career with Grumman, I was assigned to management teams developing a series of new carrier-based aircraft for the Navy, and was the Business and Contracts Manager of the Grumman/NASA Lunar Module of Project Apollo. All of these programs employed innovative and break-through technologies, but the Lunar module was the most advanced. Many of the technologies developed for Project Apollo, such as fuel cells and high reliability semi-conductors, are essential to the success of advanced and innovative energy projects.

My professional affiliations include:

- Association of Energy Engineers
- Society of Naval Architects and Marine Engineers
- National Contract Management Association
- Associate Member, American Bar Association, Section of Public Contract Law

1 46 CFR Part 298

2 SDI Letter dated 6 November 2005 to Douglas Kaempf, DOE Biomass Program Office

1.2 TITLE XI AS A MODEL

The table below summarizes the differences between the two programs.

Figure 1-1
Comparison of Parameters of Title XI and Title XVII

Parameter	MARAD Title XI	DOE Title XVII
Guaranteed debt as a percentage of Project Cost	Not to exceed 87.5%	Not to exceed 80%
Guarantee as a percentage of the debt obligation	100%	90%
Equity contribution	Must be in cash (Note 1)	Can be borrowed
Maximum Term of the guarantee	25 years	30 years or 90% of the useful life of the physical assets, whichever is less
Quality of the debt	AAA (Treasury Bond rating)	Credit rating of the borrower
Marketability of the debt	Freely tradable	Limited
Interest rate	A few basis points above comparable term Treasury	Indeterminate
Application fee	$5,000 (credited to Investigation fee if approved)	First Fee Not yet established
Investigation fee	½ of 1% on first $10 million plus 1/8 of 1% on balance	Second Fee Not yet established
Guarantee fee	Not less than ½ of 1% nor more than 1% on balances, discounted to present value	Third Fee Subsidy Cost as approved by OMB
Guaranty fee financed?	Yes (same % as guarantee)	No
History for Subsidy Cost	Extensive. Approved by OMB	None
Regulations in place	Yes (46 CFR Part 298)	In review (10 CFR 609)
Administration	MARAD in house	Shared with lender
Note (1) Additional long-term debt may be treated as equity if fully subordinated and approved by the Maritime Administrator		

1.3 PROGRAMMATIC ISSUES

Our comments are presented as discussions of five (5) significant programmatic issues:

1. Applicability to existing Pre-Application proposals (Section 2);
2. Application procedures (Section 3);
3. Project eligibility (Section 4);
4. Project and transaction costs (Section 5);
5. Financial considerations (Section 6).

SECTION 2
APPLICABILITY TO EXISTING PRE-APPLICATIONS

On page 8 of the Preamble, DOE states that in order not to prejudice Applicants who submitted Pre-Application proposals in response to the August 2006 Solicitation, the proposed Rules "...shall not apply to the Pre-Applications, Applications, Conditional Commitments, and Loan Guarantee Agreements pursuant to the August 2006 solicitation" except for the default, record-keeping and audit requirements in the proposed Regulations.

We respectfully submit that it would be a mistake, at the outset of the new program, to exempt any group of Applicants from the proposed Rules or any parts thereof.

Applicants who submitted Pre-Application proposals before the 31 December 2006 deadline were on notice that in the event their proposed projects were considered eligible, "DOE *may* (emphasis added) invite the interested party to submit a comprehensive Application". We believe that it is implicit in the August 2006 Solicitation and Guidelines that DOE retained the right to require changes or modifications to an Applicant's Pre-Application proposal as a condition of issuing a Letter Commitment. Further, the Guidelines stated (on page 5, continued on page 6) "Please note that even if a Pre-Application or Application contains all of the information specified in these Guidelines, DOE retains the right, in its sole discretion, to inform any Applicant that their project proposal has been denied further review."

In footnote 5 on page 20 of the 2006 Guidelines, DOE stated, "...neither the Pre-Application nor any written or other feed-back that DOE may provide in response to the Pre-Application is intended to obviate the need for an (comprehensive) Application. In addition, any response that DOE may provide to a Pre-Application or subsequent Application does not obligate DOE to issue a loan guarantee for a project..."

To the best of our knowledge, no invitations have been issued, so such invitations to submit comprehensive Application as may be issued to Applicants who submitted Pre-Application proposals in response to the August 2006 solicitation should require compliance with ***all*** of the requirements set forth in the Final Rules. In our opinion, there is nothing prejudicial in such a requirement. In fact, we submit that if DOE were to waive any regulatory requirements set forth in the Final Rules for early Applicants, it would be prejudicial to Applicants who submit Applications that are fully compliant with the Regulations in response to subsequent solicitations.

2.1.1 Recommended Changes to the Proposed Rules

Make the following changes to § 609.1 - Purpose and Scope:

- (c)(1) This part shall ~~not~~ apply to any Pre-Applications....
- Delete paragraphs (c)(2) and (c)(3)

SECTION 3
APPLICATION PROCEDURES

The Guidelines issued in August 2006 and the proposed Rules create a lengthy and costly application process as depicted in the diagram below.

<table>
<tr><th colspan="8">Procedural Steps & Milestones for DOE Title XVII Loan Guarantees</th></tr>
<tr><td>Solicitation</td><td colspan="7">1 DOE issues a solicitation</td></tr>
<tr><td></td><td>Pre-App proposals</td><td colspan="6">2 Applicants pay First Fee if required by the Solicitation</td></tr>
<tr><td></td><td></td><td>Screen Pre-Apps Invite full Applications</td><td colspan="5">3 DOE screens the Pre-Applications for eligibility Issues Invitations to those considered eligible and compliant with program requirements.</td></tr>
<tr><td></td><td></td><td></td><td>Application proposals</td><td colspan="4">4 Invited Applicants pay First Fee if not paid with the Pre-Application</td></tr>
<tr><td colspan="4">5 DOE selects applications likely to be accepted
6 Selected applicants pay the Second Fee</td><td>Select proposals</td><td colspan="3"></td></tr>
<tr><td colspan="5">7 DOE conducts comprehensive due-diligence evaluation
8 DOE issues Term Sheet</td><td>Due-diligence</td><td colspan="2"></td></tr>
<tr><td></td><td></td><td colspan="4">9 DOE and the Applicant (and their respective attorneys) negotiate the Terms and draft documents</td><td>Negotiate terms</td><td></td></tr>
<tr><td></td><td></td><td colspan="5">10 Borrower pays Third Fee at Closing</td><td>Close</td></tr>
</table>

MILESTONE EVENTS:

1. DOE is required to issue a Solicitation that sets forth the types of projects to be considered eligible, the total amount of the loan guarantee authority that will be available for this round of guarantees and the amount of the First Fee (§609.6 (c), if any.
2. Applicants submit a Pre-Application proposal and pay the First Fee, if required by the Solicitation.
3. DOE conducts a preliminary evaluation of the Pre-Application proposals and issues Invitations to submit Application proposals to those Applicants whose projects are considered eligible.
4. Selected Applicants submit Application proposals and pay the First Fee, if not already paid with the Pre-Application proposal.
5. DOE evaluates Application proposals and selects those for full due-diligence
6. Selected Applicants pay the Second Fee as a condition for DOE to proceed into the Term Sheet phase.
7. DOE performs comprehensive due-diligence.
8. DOE issues a Term Sheet for Applications that are considered likely to be approved.
9. Applicant, DOE and Lender negotiate requirements set forth in the Term Sheet and draft Closing documents
10. At the time the guaranteed loan is Closed, the Applicant (now called Borrower) is required to pay the Third Fee, the Subsidy Cost of the guarantee.

5.1 RECOMMENDED CHANGES

Eliminate the Pre-Application Proposal

The requirements for a Pre-Application as set forth in **§609.4** are almost as extensive as those for a full Application as set forth in **§609.6**, which not only makes the Pre-Application redundant, but adds many months to the process. We recommend that the formal Pre-Application be replaced by an informal conference — similar to the procedure that MARAD uses — to determine whether or not the Project is eligible and that the Applicant will be able to fulfill the requirements set forth in **§609.6**. This will save time and effort for both the Applicant and DOE and will enable the Applicant to ask questions at the beginning of the process.

Establish time lines in the Rules

There should be time lines for the times allowed DOE for evaluating Applications, issuing Term Sheets and Closing, but the Secretary should be given the authority to extend the time lines if deemed necessary.

Change the names of the Fees

The terminology "First, Second and Third Fees" is vague and non-descriptive. We recommend that the fees be named Application Fee (First Fee), Investigation Fee (Second Fee) and Guarantee Fee (Third Fee). This conforms to the terminology of Title XI.

Establish the amounts of the fees in the Rules

The amount of the fees should be established in the Rules, either in dollar amounts or by formula.

Credit the Application Fee to the Investigation Fee

The Application fee should be non-refundable, but credited to the Investigation fee if the Project is considered eligible and DOE proceeds into the due-diligence phase.

Include the Guarantee Fee in the Guaranteed Financing

The amount of the Guarantee Fee should be included in the Project Cost, and therefore included in the financing, as is the case in the Title XI program. See Section 6.

§609.9 (d)(1) requires that DOE receive payment of the Credit Subsidy Cost from <u>either</u> (but not from a combination) of the following:

(i) A Congressional appropriation of funds; or
(ii) a payment from the Borrower.

We read this language to mean that if Congress appropriates funds for the Credit Subsidy Costs the Borrowers will pay nothing. We do not believe that is DOE's intent, nor should it be.

We believe that Borrowers whose loans are guaranteed should pay a reasonable premium based on an evaluation of the risk factors in their projects, as is the case with the Title XI program.

MARAD calculates the Title XI guarantee fee based on the loan balances outstanding after periodic principal payments throughout the term of the loan, discounted to present value. The Borrower is required to pay the entire amount so calculated at Closing, but the amount so paid is included as an element of cost in determining the amount of the guaranteed debt. In other words, the Guarantee Fee is financed.

SECTION 4
PROJECT ELIGIBILITY

The proposed Rules contain a complex, and often contradictory, set of criteria to assess the technological eligibility of projects for loan guarantees. This problem was created by Title XVII of the Energy Policy Act of 2005 (EPA05)[3]. In the Preamble to the proposed Rules, DOE states, "Indeed, when read together, section 1701 and 1703 of Title XVII prohibit DOE from issuing guarantees for projects that only use commercial technologies that are in general use in the United States at the time the guarantee is issued."

In addition to making appropriate changes to the proposed Rules, as recommended herein, we recognize that it may be necessary to amend EPA05.

DOE also notes in the Preamble that Title XVII authorizes loan guarantees for projects that "employ new or significantly improved technologies as compared to commercial technologies in service in the United States at the time the guarantee is issued" but not for projects that employ a technology that is "solely in use in a demonstration project funded by DOE". We note that this language differs from that on page 4 of the Advance Notice which simply stated "DOE's loan guarantee program is not intended for technologies in research and development." However, the proposed Rules contain language that contradicts that statement.

Specifically, in **§609.2** - Definitions New or Significantly Improved Technology means "a technology that has only recently been discovered or learned, or that involves or constitutes one or more meaningful and important improvements in the productivity or value of the technology".

In our opinion, the first phrase clearly defines a technology that is still in the early research and development phase; while the second can be construed to mean an improvement to an existing manufacturing or production processes. This dichotomy creates two significantly different scenarios with dramatically different technical and financial risks:

1. A new facility or process based on one or more recently-discovered technologies not currently in commercial use in the United States; or
2. Modifications to, or expansion of, an existing facility to install or incorporate modern, advanced and innovative technologies.

On page 10 of the Preamble, DOE requires that "technologies for project proposals must be mature enough to assure dependable commercial operations that generate sufficient revenues to service the project's debt."

In other words, how much new and innovative technology will be sufficient to establish eligibility, and what must the stage of development of such technologies be in order that they be judged to be mature enough to be economically sound, yet innovative enough to be eligible?

In the event that an Applicant claims eligibility for a project that DOE does not consider sufficiently advanced and innovative and therefore is rejected, the scene is set for controversy and intervention by members of Congress on behalf of a constituent Applicant.

3 Public Law 109-58

4.1 RECOMMENDED CHANGES TO THE PROPOSED RULES

***Add the following paragraph, adapted from §298.2 of MARAD's Title XI regulations, to §609.1 - Purpose and Scope*:**
(a) The purpose of this Part is to establish policies and procedures for issuing loan guarantees for projects that introduce one or more technologies into American energy-related production or manufacturing facilities comprised of the best available proven technology, techniques, and processes appropriate to advancing the state-of-the-art of the applicant's facilities, or exceeds the best available processes of American energy-related facilities, and that will enhance its productivity and make it more competitive and energy efficient.

Renumber subsequent paragraphs accordingly.

As noted above, it will also be necessary to amend Title XVII of EPA05.

SECTION 5
PROJECT & TRANSACTION COSTS

Section §609.12 of the proposed Rules requires DOE to "...determine the estimated Project Costs...." based on itemized estimates submitted by the Applicant of such elements of cost that the Applicant believes are "in accordance with generally accepted accounting principals and practices" and lists 12 types of cost elements that can be included in calculating the Project Costs, which is the basis for the amount of the financing that can be guaranteed. It also lists eight (8) types of cost elements that cannot be included in the Project Cost for purposes of determining the amount of the guarantee.

Taken all together, the inclusions and exclusions set forth in **§609.12** do not, in our opinion, conform to Generally Accepted Accounting Principals or to the Internal Revenue Code. Neither do the regulations that govern the Maritime Administration's Title XI loan guarantee program, so this issue has been a topic of discussion among Title XI practitioners for many years. Therefore, our comments are presented in the context of those discussions.

5.1 INTERNAL REVENUE CODE

Section 263A of the Internal Revenue Code requires the cost of acquiring tangible personal property for use in a business and its share of allocable indirect costs to be capitalized.

IRS Publication 551 titled "Basis of Assets" states,

"The basis of property you buy is usually its cost. The cost is the amount you pay in cash, debt obligations, other property or services. Your cost also includes the amounts you pay for the following items:

1 Sales taxes charged to the purchase
2 Freight charges to obtain the property
3 Installation and testing charges
4 Excise taxes
5 Legal and accounting fees (when they must be capitalized)
6 Revenue stamps
7 Recording fees."

The Uniform Capitalization Rules apply. Publication 551 states,

"Under the uniform capitalization rules, you *must* (emphasis added) capitalize all direct costs and an allocable part of most indirect costs....The term **capitalize** (emphasis in the text) means to include certain expenses in the basis of property you produce .... rather than deduct them as a current expense. You recover those costs through deductions for depreciation, amortization or cost or goods sold when you use, sell or otherwise dispose of the property.

Any cost you cannot use to figure your taxable income for any tax year is not subject to the uniform capitalization rules."

5.1.1 Research and Experimental Costs

Research and experimental expenses are not subject to the uniform capitalization rules, however they are allowable as a deduction under Section 174 of the IRS Code, which states

"A taxpayer may treat research or experimental expenditures that are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to a capital account. The expenditures so treated shall be allowed as a deduction."

5.1.2 Start-Up Expenditures

Section 195 of the Code defines start-up expenditures as any amount paid or incurred in connection with:

1. Investigating the creation or acquisition of an active trade or business, or
2. Creating an active trade or business, or
3. Any activity engaged in for profit and for the production of income before the day on which the active trade or business begins, in anticipation of such activity becoming an active trade or business, and which, if paid or incurred in connection with the operation of an existing active trade or business...would be allowable as a deduction for the taxable year in which paid or incurred. The term 'start-up expenditure' does not include any amount with respect to which a deduction is allowable under section 163(a) [interest on indebtedness], 164 [taxes] or 174 [research and experimental expenditures]

The Code defines business start-up expenditures as "costs for creating an active trade or business or investigating the creation or acquisition of an active trade or business"
A start-up cost can be capitalized and amortized over a period of not less than 60 months. A start-up cost can be amortized if it meets both of the following tests:

- It is a cost you could deduct if you paid or incurred it to operate an existing active trade or business (in the same field as the one you entered into) and
- It is a cost you pay or incur before the day your active trade or business begins.

Allowable and amortizable costs include:

- An analysis of potential markets, products, labor supply, transportation facilities, etc.
- Advertisements for the opening of the business
- Salaries and wages for employees who are being trained and their instructors
- Travel and other necessary costs for securing prospective distributors, suppliers or customers
- Salaries and fees for executives and consultants, or for similar professional services."

5.2 COST ACCOUNTING STANDARDS

Public Law 100-679[4] requires that certain federal contractors and subcontractors comply with Cost Accounting Standards. The covered companies are required to set forth their accounting practices in a written Disclosure Statement and then to consistently comply with those practices. The regulations governing the cost accounting standards are set forth in 48 CFR Chapter 99. While the standards are not mandatory for companies that are not contractors or subcontractors to the Government, the guidance is applicable to the subject under discussion. Selected text from the Cost Accounting Standards Board regulations are set out in quotation marks.

Standard 9904.404 requires "...for the purposes[5] of cost measurement, contractors establish and adhere to policies with respect to capitalization of tangible assets which satisfy criteria set forth herein. Normally, cost measurements are based on the concept of enterprise continuity (which) implies that major asset acquisitions will be capitalized...A capitalization policy[6] in accordance with this Standard will facilitate measurement of costs consistently over time."

"The cost[7] to acquire a tangible capital asset includes the purchase price of the asset and costs

4 41 USC 422
5 9904.404-20 Purpose
6 Capitalization policy is defined in 9904.404-40
7 9904.404-50

necessary to prepare the asset for use... Costs necessary to prepare the asset for use include the cost of placing the asset in location and bringing the asset to a condition necessary for normal and expected use. Where material in amount, such costs, including initial inspection and testing, installation and similar expenses, shall be capitalized."

"Tangible capital assets constructed or fabricated by the contractor for its own use shall be capitalized[8] at amounts which include all indirect costs properly allocable to such assets. This requires the capitalization of general and administrative expenses when such expenses are identifiable with the constructed asset and are material in amount (*e.g.*, when the in-house construction effort requires planning, supervisory or other significant effort by officers or other personnel whose salaries are regularly charged to general and administrative expenses)".

5.3 RECOMMENDED CHANGES TO THE PROPOSED RULES

Delete "lease or rental" from first line of §609.12 (b)(1) and add the following at the end of this sub-paragraph:

"If the real property and any improvements existing thereon are to be acquired by lease or rental, the term of the lease or rental agreement shall not be less than the term of the guaranteed debt and the owner of the real property shall issue an absolute and irrevocable Waiver of Lien in favor of the Lender(s), Holder(s) and the United States in a form and on terms satisfactory to the Secretary. If the real property to be leased is encumbered by debt, the lender(s) and holder(s) of such debt shall issue an absolute and irrevocable Mortgagee's Waiver of Lien in favor of the Lender(s) or Holder(s) of the guaranteed debt and the United States in a form and on terms satisfactory to the Secretary. "

Add a new sub-paragraph to §609.12 (b)

"(13) Borrower-paid Credit Subsidy Costs, whether required to paid in a dollar amount determined by the Secretary or as a Guarantee Fee in an amount set forth in the Loan Agreement."

Add a new sub-paragraph to §609.12 (b):

"(14) Professional fees and expenses, including legal fees, accounting fees, the costs of obtaining the credit ratings required by §609.6 (b)(21) and §609.9 (f), such other costs as may be incurred in preparation of an Application proposal and negotiation of the Loan Guarantee Agreement together with allocable overhead expenses."

Delete §609.12 (c)(1)

because it contradicts §609.12 (b)(6) which allows inclusion of "The cost of issuing project debt, such as fees, transaction and legal costs and other normal charges imposed by Lenders and other Holders."

Delete §609.12 (c)(7)

to be consistent with the new sub-paragraph (13) recommended to be added to §609.12 (b).

Delete §609.12 (c)(8)

because it is inconsistent with the Internal Revenue Code as cited above. The date a new asset is accepted by the owner generally marks the commencement of the term of permanent financing; therefore, replace with "Post-acceptance operating expenses."

8 9904.404-50(b)

SECTION 6
FINANCING ISSUES

The proposed Rules create a partnership relationship between the Government, as represented by DOE, and an Eligible Lender. This arrangement is similar to that of the Small Business Administration's 7(a) loan guarantee program in which an Eligible Lender receives an application from a prospective Borrower, conducts due diligence and issues a commitment conditioned upon obtaining a guarantee from the SBA acting on behalf of the Government. The SBA program works well because the vast majority of the loans it guarantees are for projects with low technical risk, are fully secured by hard collateral, and with a maximum loan amount of $2 million, are for amounts well below the threshold contemplated by the Title XVII program.

DOE's proposed Rules do not set a minimum loan amount (nor does MARAD's Title XI), but the relatively high transaction costs and time required from Pre-Application to Closing, indicates that for all practical purposes, the threshold is at least $20 million.

We recommend that the structure be changed in two fundamental respects.

1. ***Guarantee 100% of the approved Project Cost;***
2. ***Assign the entire responsibility to DOE for originating, structuring and approving the financing and for administering the guaranteed loan throughout its term.***

Under this structure — which is the way the Title XI program is structured — the debt obligations will be AAA-rated paper (the same as U.S. Treasuries), regardless of the credit rating of the Borrower. This means that commitments to provide the funds at Closing can be readily obtained from institutional investors, usually in a matter of days or even hours. Furthermore, with all or part of its long term debt rated AAA, the Borrower will be more attractive to the financial community, which enhances its ability to obtain short-term credit facilities for working capital.

Senator Harry Reid, the Senate Majority Leader, introduced a Bill (S.1419) on 17 May 2007 that, among other things, would permit the Secretary to guarantee 100% of the debt issued for the first six (6) renewable fuel facility projects approved pursuant to the authorization in the Continuing Resolution that funds the Title XVII program in fiscal year 2007.

S.1419 also requires the Secretary to approve or disapprove an application not later than 90 days after the date of receipt of an application (assumed to be a full, comprehensive and complete Application as described in Section 3 of these comments).

Accordingly, ***we recommend deleting §609.10 (d)(3)*** which states that the loan guarantee is limited to 90% of the face value of the loan(s) or other debt obligation(s) and **§609.10 (d)(4)** which prohibits separating or "stripping" the guaranteed portion of the loan from the total if the debt is to be participated, syndicated or otherwise resold in the secondary debt market.

6.1 RISK MITIGATION

The purpose a Federal loan guarantee program is to enhance the terms of financing available from the financial community, not to make the Federal government the sub-prime lender of last resort for high technical risk projects. The Government made that mistake once before when the so-called SynFuel program was authorized by the Federal Nonnuclear Energy Research and Development Act of 1974 [9].

We believe that the technical and financial risks can be mitigated if the following basic requirements are invoked as DOE policy and set forth in the proposed Rules:

- The project sponsor and its joint venture partners, if any (the Applicant) must be a well-established for-profit business organization in sound financial condition as evidenced by at least three (3) years of audited financial statements;
- If the Applicant is to be a new business entity created for the purpose, the project sponsor and its joint venture partners, if any, shall also guarantee the debt of the newly-formed business entity;
- The Applicant must have experienced management, scientific and engineering staffs in place at the time it submits its Application;
- Contractors must be established firms with experience constructing the type of facilities proposed for the project, and must provide performance bonds;
- The equity investment in the project must be in cash, to be deposited into an Escrow Fund (see Section 6.2 *supra*) at the time of Closing.
- Working capital at the time of Closing must be at least equal to 6 months of debt service (principal and interest) plus one year of insurance premiums; and
- The ratio of long-term debt to equity, with the guaranteed loan in place, must be acceptable to the Secretary.

Furthermore, before issuing a Guarantee, the Secretary shall be required to issue a finding that the project is technically and economically sound. A statement from the Applicant that it believes that there is a "reasonable prospect" that the Guaranteed Obligations will be fully paid from project revenues as set forth in **§609.6 (b)(28)** is insufficient. The responsibility for making this determination should rest solely with DOE, as is the case with the Title XI program where the Secretary is required to make a finding that the project meets the test of "economic soundness."[10]

6.2 ESCROW FUND

There should be a requirement the proposed Rules that the Borrower and the DOE Loan Guarantee Office establish an escrow fund into which the proceeds of the guaranteed loan, the equity contributions of the Borrower, and an amount equal to at least six months of interest on the obligations are to be deposited at the time of Closing. This arrangement requires both the agency and the Borrower to approve requests for disbursement of funds from the Escrow account.

The requirement for an escrow fund is set forth in §298.33 of the Title XI regulations. The first paragraph reads:

> "At the time of the sale of the Obligations, the Obligor shall deposit with the Depository in an escrow fund (the "Escrow Fund") all of the proceeds of that sale unless the Obligor is entitled to withdraw funds under paragraph (b) of this section. The Obligor must also deposit into the Escrow Fund on the Closing date an amount equal to six months interest at the rate borne by the Obligations, unless we find the existence of adequate consideration or accept other consideration in lieu of the interest deposit".

9 Public Law 93-577

10 The criteria on which MARAD bases its determination of the "economic soundness" of a project is set forth in considerable detail in 46 CFR 298.14.

In addition, in order to protect the Government's interests in the event of a default during the construction period, the Title XI program now requires that payments to contractors, vendors and suppliers during the construction be drawn first from the Borrower's equity portion of the Escrow account before drawing on funds deposited from the proceeds of the guaranteed loan. ***We recommend that such a provision be incorporated in the Proposed Rules.***

6.3 ADMINISTRATION OF GUARANTEED LOANS

The proposed Rules assigns primary responsibility for servicing the debt and monitoring the performance of the Borrower to the Eligible Lender (as defined in **§609.11** of the proposed Rules). This not only assigns responsibility for monitoring the financial performance of the Borrower, but also responsibility for technical performance and regulatory compliance. Since there will be a large number of Lenders, standards and procedures will vary widely.

Under the Title XI program, the Maritime Administration is fully responsible for administering the program and ensuring compliance with the terms of the loan agreements. As was noted during the investigations and hearings conducted by the DOT Inspector General and the Government Accountability Office, MARAD had not adequately fulfilled its obligations under the statute. It has since taken actions to correct that situation. Among other things, MARAD has restructured its organization to create "firewalls" between the entities that originate guaranteed loans, administer those loans, and deal with defaults. ***We recommend that DOE emulate this organizational structure.***

6.3.1 Consultants and Advisors

MARAD is authorized to engage independent consultants to assist in evaluating applications for loan guarantees, particularly those that involve advanced technologies, if MARAD does not have people on its staff sufficiently knowledgeable about such technologies. ***We recommend that such a provision be incorporated in the proposed Rules.***